

AUDITING PROCEDURES REPORT

Issued under P.A. 2 of 1968, as amended. Filing is mandatory.

Local Government Type: <input type="checkbox"/> City <input type="checkbox"/> Township <input type="checkbox"/> Village <input checked="" type="checkbox"/> Other		Local Government Name: <u>City of Pontiac Police and Fire Retiree Prefunded Group</u> <u>Health and Insurance Trust</u>	County Oakland
Audit Date December 31, 2005	Opinion Date April 28, 2006	Date Accountant Report Submitted To State: June 30, 2006	

We have audited the financial statements of this local unit of government and rendered an opinion on financial statements prepared in accordance with the Statements of the Governmental Accounting Standards Board (GASB) and the *Uniform Reporting Format for Financial Statements for Counties and Local Units of Government in Michigan* by the Michigan Department of Treasury.

We affirm that:

1. We have complied with the *Bulletin for the Audits of Local Units of Government in Michigan* as revised.
2. We are certified public accountants registered to practice in Michigan.

We further affirm the following. "Yes" responses have been disclosed in the financial statements, including the notes, or in the report of comments and recommendations.

You must check the applicable box for each item below:

- | | |
|---|---|
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 1. Certain component units/funds/agencies of the local unit are excluded from the financial statements. |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 2. There are accumulated deficits in one or more of this unit's unreserved fund balances/retained earnings (P.A. 275 of 1980). |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 3. There are instances of non-compliance with the Uniform Accounting and Budgeting Act (P.A. 2 of 1968, as amended). |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 4. The local unit has violated the conditions of either an order issued under the Municipal Finance Act or its requirements, or an order issued under the Emergency Municipal Loan Act. |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 5. The local unit holds deposits/investments which do not comply with statutory requirements. (P.A. 20 of 1943, as amended [MCL 129.91] or P.A. 55 of 1982, as amended [MCL 38.1132]) |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 6. The local unit has been delinquent in distributing tax revenues that were collected for another taxing unit. |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 7. The local unit has violated the Constitutional requirement (Article 9, Section 24) to fund current year earned pension benefits (normal costs) in the current year. If the plan is more than 100% funded and the overfunding credits are more than the normal cost requirement, no contributions are due (paid during the year). |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 8. The local unit uses credit cards and has not adopted an applicable policy as required by P.A. 266 of 1995 (MCL 129.241). |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 9. The local unit has not adopted an investment policy as required by P.A. 196 of 1997 (MCL 129.95). |

We have enclosed the following:	Enclosed	To Be Forwarded	Not Required
The letter of comments and recommendations.	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Reports on individual federal assistance programs (program audits).	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Single Audit Reports (ASLGU).	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>

Certified Public Accountant (Firm Name): PLANTE & MORAN, PLLC			
Street Address 27400 Northwestern Highway	City Southfield	State MI	ZIP 48037
Accountant Signature <i>Plante & Moran, PLLC</i>			

City of Pontiac
Police and Fire Retiree Prefunded
Group Health and Insurance Trust

Financial Report
with Supplemental Information
December 31, 2005

City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust

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Independent Auditor's Report

To the Board of Trustees
City of Pontiac Police and Fire Retiree Prefunded
Group Health and Insurance Trust

We have audited the accompanying statement of trust net assets of the City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust (a component unit of the City of Pontiac, Michigan) as of December 31, 2005 and the related statement of changes in trust net assets for the year then ended. These financial statements are the responsibility of the board of trustees of the Police and Fire Retiree Prefunded Group Health and Insurance Trust of the City of Pontiac. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust as of December 31, 2005 and the results of its operations for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis (identified in the table of contents) is not a required part of the basic financial statements but is supplemental information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the required supplemental information. However, we did not audit the information and express no opinion on it.

Plante & Moran, PLLC

April 28, 2006

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City of Pontiac

Police and Fire Retiree Prefunded Group Health and Insurance Trust

Management's Discussion and Analysis

Using this Annual Report

This annual report consists of two parts: (1) management's discussion and analysis (this section) and (2) the basic financial statements. The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data.

Condensed Financial Information

The table below compares key financial information in a condensed format between the current year and the prior year:

	Fiscal Year Ended December 31	
	2005	2004
Total assets	\$ 24,450,837	\$ 21,639,960
Total liabilities	<u>672,243</u>	<u>1,741,009</u>
Net trust assets	<u>\$ 23,778,594</u>	<u>\$ 19,898,951</u>
Net investment gain	\$ 2,112,507	\$ 3,158,204
Contributions - Employer	3,258,180	3,411,061
Retiree health benefits paid	<u>1,466,072</u>	<u>1,227,096</u>
Contributions in excess of benefits paid	1,792,108	2,183,965
Ratio of contributions to benefits paid	222.2%	278.0%
General and administrative expenses	<u>24,972</u>	<u>17,171</u>
Net increase in trust net assets	<u>\$ 3,879,643</u>	<u>\$ 5,324,998</u>

City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust

Management's Discussion and Analysis (Continued)

Overall Fund Structure and Objectives

The City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust (the "Trust") exists to pay health care benefits to members retiring on or after August 22, 1996. Benefits currently being paid are significantly less than contributions currently being received. The excess of contributions over benefits paid will allow for additional funding to increase investment income to a level where the Trust will generate adequate earnings to pay future benefits. The public capital markets represent the primary source of investments.

Asset Allocation

The Trust has established asset allocation policies, which are expected to deliver more than enough investment income over a very long period of time to satisfy the obligations to pay the benefits promised to the members of the Trust. The following is a summary of the asset allocation as of December 31, 2005:

Domestic equities	65%
International equities	15%
Domestic fixed income	20%

Investment Results

While returns were down from the prior year, both the domestic equity and domestic bond markets posted positive returns during the past year. In 2005, U.S. equities were again helped by strong profits, as well as by the expectation that the federal reserve would raise rates only one or two more times during the first quarter of 2006 and may even begin to lower rates by the end of 2006. U.S. bonds were helped by benign inflation reports and continued foreign investment in domestic bonds. The domestic equity market, as measured by the S&P 500 Index, returned 4.9 percent for the year. The fixed income market, as measured by the Lehman Aggregate Index, returned 2.0 percent for the year. The international equity market, as measured by the MCSI EAFE (non-U.S.) Index returned 13.5 percent for the year. The total fund returned 9.24 percent for the year.

The City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust's total fund return must always be considered in a longer-term context. The asset allocation of each fund is built upon the foundation that the obligations of the Trust to pay the benefits promised to members and retirees are very long-term obligations. Accordingly, the board of trustees must make investment decisions that it believes will be the most beneficial to the Trust over many years, not just one or two years.

**City of Pontiac
Police and Fire Retiree Prefunded
Group Health and Insurance Trust**

**Statement of Trust Net Assets
December 31, 2005**

Assets

Investments at fair value - Money market and mutual funds (Note 2)	\$ 24,386,320
Due from City of Pontiac Police and Fire Retirement System	<u>64,517</u>

Total assets 24,450,837

Liabilities

Due to City of Pontiac	656,030
Accounts payable	<u>16,213</u>

Total liabilities 672,243

Trust Net Assets \$ 23,778,594

City of Pontiac
Police and Fire Retiree Prefunded
Group Health and Insurance Trust

Statement of Changes in Trust Net Assets
Year Ended December 31, 2005

Additions

Investment income:	
Interest and dividend income	\$ 412,040
Net appreciation in fair value of investments	1,715,467
Investment advisor fees	<u>(15,000)</u>
Net investment gain	2,112,507
Contributions - Employer	<u>3,258,180</u>
Total additions	5,370,687

Deductions

Retirees' health benefits	1,466,072
Other expenses	<u>24,972</u>
Total deductions	<u>1,491,044</u>

Net Increase in Trust Net Assets	3,879,643
Trust Net Assets - January 1, 2005	<u>19,898,951</u>
Trust Net Assets - December 31, 2005	<u>\$ 23,778,594</u>

City of Pontiac

Police and Fire Retiree Prefunded Group Health and Insurance Trust

Notes to Financial Statements
December 31, 2005

Note 1 - Summary of Significant Accounting Policies

The City of Pontiac (the "City") has established an irrevocable prefunded group health and insurance trust fund, for health, optical, dental, and life insurance benefits for retirees who are members of the Police and Fire Retirement System of the City of Pontiac and who retired on or after August 22, 1996. The City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust (the "Trust") was created as an Internal Revenue Code 501(c)(9) Trust (VEBA). The Police and Fire Retirement System (the "Retirement System") performs the Trust's accounting function.

Reporting Entity - The Trust is a component unit of the City of Pontiac, Michigan. The Trust does not hold securities of or loans to the Retirement System.

Basis of Accounting - The City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust's financial statements are prepared using the accrual basis of accounting. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Insurance costs are recognized when due and payable in accordance with the terms of the Trust.

Investments - Investments are reported at fair value. Money market funds and mutual fund investments are valued at net asset value. Dividend income is recorded on the ex-dividend date. Income from other investments is recorded as earned on an accrual basis. In accordance with the policy of stating investments at fair value, net unrealized appreciation or depreciation for the year is reflected in the statement of changes in trust net assets.

Federal Income Taxes - The Trust is exempt from income tax under Section 501(a).

City of Pontiac

Police and Fire Retiree Prefunded

Group Health and Insurance Trust

Notes to Financial Statements

December 31, 2005

Note 2 - Investments

Michigan Compiled Laws Section 129.91 (Public Act 20 of 1943, as amended) authorizes local governmental units to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations that have offices in Michigan. The local unit is allowed to invest in bonds, securities, and other direct obligations of the United States or any agency or instrumentality of the United States; repurchase agreements; bankers' acceptances of United States banks; commercial paper rated within the two highest classifications, which matures not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions, which are rated as investment grade; and mutual funds composed of investment vehicles that are legal for direct investment by local units of government in Michigan.

The retiree health care fund is also authorized by Michigan Public Act 314 of 1965, as amended, to invest in certain reverse repurchase agreements, stocks, diversified investment companies, annuity investment contracts, real estate leased to public entities, mortgages, debt or equity of certain small businesses, certain state and local government obligations, and certain other specified investment vehicles.

The Trust has designated one bank for the deposit of its funds. The investment policy adopted by the board in accordance with Public Act 196 of 1997 has authorized investment in mutual or commingled funds, but not the remainder of state statutory authority as listed above. The Trust's deposits and investment policies are in accordance with statutory authority.

The Trust's cash and investments are subject to several types of risk, which are examined in more detail below:

Interest Rate Risk

Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. The Trust's investment policy does not restrict investment maturities. At year end, the average maturities of investments are as follows:

<u>Investment</u>	<u>Fair Value</u>	<u>Weighted Average Maturity</u>
Mutual fund	\$ 3,901,494	5.7 years

City of Pontiac **Police and Fire Retiree Prefunded** **Group Health and Insurance Trust**

Notes to Financial Statements **December 31, 2005**

Note 2 - Investments (Continued)

Credit Risk

State law limits investments in commercial paper to the top two ratings issued by nationally recognized statistical rating organizations. The Trust has no investment policy that would further limit its investment choices. As of year end, the credit quality ratings of debt securities (other than the U.S. government) are as follows:

Investment	Fair Value	Rating	Rating Organization
Mutual fund	\$ 23,409	AAA	S&P
Mutual fund	42,916	AA	S&P
Mutual fund	152,158	A	S&P
Mutual fund	495,490	BBB	S&P
Mutual fund	468,179	BB	S&P
Mutual fund	35,113	B	S&P
Mutual fund	89,734	Not rated	N/A

Note 3 - Trust Contribution Information

The Trust is funded by employer contributions. An actuarial valuation was performed as of December 31, 2002 which arrived at a required employer contribution rate of 21.49 percent of police and fire wages. The City funded at this level through June 30, 2005. As of December 31, 2004, an updated actuarial valuation was performed which recommended an employer contribution of 21.02 percent of police and fire wages. The trustees voted to implement a contribution rate of 20.79 percent of police and fire wages beginning July 1, 2005 and continued to fund at this level through December 31, 2005.

Note 4 - Trustees

Two trustees of the City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust as of December 31, 2005 were elected by the membership, two sit by virtue of their position, and one is appointed by the other trustees.

June 23, 2006

To Mr. Charlie Harrison III, Chairman (GERS)
To Mr. Craig Storum, Chairman (PFRS)
To Mr. Ray Cochran, Chairman (General VEBA)
To Mr. Brian Lee, Chairman (Police and Fire VEBA)
To the City of Pontiac Retirement Board's
General Employees Retirement System
and Police and Fire Retirement System
47450 Woodward Ave
Pontiac, MI 48342

Dear Mr. Harrison, Mr. Storum, Mr. Cochran, and Mr. Lee:

We recently completed the audits of the General Employees Retirement System and the Police and Fire Retirement System (the "Systems"), as well as the related VEBAs, for the year ended December 31, 2005. We continue to be impressed with the organized and thorough manner in which Deborah Munson prepared for the audit. Her assistance in preparing the necessary schedules was greatly appreciated. As a result of the audit, we offer the following comments and recommendations for your consideration:

Retiree Health Care Benefits

The Governmental Accounting Standards Board recently released Statement Number 45, *Accounting and Reporting by Employers for Postemployment Benefits Other Than Pensions*. The new pronouncement provides guidance for local units of government in recognizing the cost of retiree health care, as well as any "other" postemployment benefits (other than pensions). The intent of the new rules is to recognize the cost of providing retiree health care coverage over the working life of the employee, rather than at the time the health care premiums are paid.

The new pronouncement will require the Systems to obtain a valuation of the obligation to provide retiree health care benefits, including an amortization of the past service cost over a period of up to 30 years. The valuation must include an annual recommended contribution (ARC). While the ARC does not need to be funded each year, any underfunding must be reported as a liability on the government-wide statement of net assets.

The GASB statement has provided substantial incentive to fund the obligation in accordance with the annual recommended contribution. In addition to the normal fairness issue of paying for a service as you use it, the GASB has directed that lower rates of return be used for evaluating the annual recommended contribution in situations where the recommended contribution is not being funded. This will significantly increase the calculation of the following year's contribution. As a result, funding the contribution on a current basis should reduce the long-run cost. The accounting change will become effective for the Systems for the year ended December 31, 2008. GASB Statement Number 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, is effective for the year ending December 31, 2007. This statement impacts the reporting and disclosures made by the plan.

Document Storage

As mentioned in the past, the Systems are responsible for keeping many important documents and records that often cannot be recreated (i.e., board minutes, member files, financial records, etc.). Given the very limited space allocated to the Systems' offices, it is difficult to provide adequate storage. It is imperative that the Systems maintain storage space that is not only well organized, but is also secure and fireproof. We recommend that the Systems review their current operating space and document storage facilities in an effort to improve conditions in order to ensure the safety of the related records.

In the past, we have suggested looking into document imaging and understand the Systems have begun to research various options as they relate to different imaging systems. Document imaging would mitigate the need to retain paper files for extended periods. Documents would instead be scanned to create an electronic backup. Document imaging, while not necessarily a new technology, is being used increasingly as a means to provide a safe and effective back-up solution while maximizing space limitations.

We also continue to suggest that the Systems should consider various aspects of disaster recovery. If there were a fire or other catastrophe and the paper records and/or computer system were destroyed, the Systems should have a disaster recovery plan in place.

Other Accounting Matters

During our testing, we noted various miscellaneous differences between the amounts recorded as receivables/payables from/to other systems. For example, the receivable from the Police and Fire VEBA recorded in the Police and Fire Retirement System is different from the payable recorded in the Police and Fire VEBA. This also occurred in some of the other systems. Although all the amounts were small, we recommend that the Systems go through and reconcile the differences to make sure the receivables and payables mirror each other.

To the Respective Chairmen
City of Pontiac Retirement Boards

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June 23, 2006

We would like to thank the Systems' staff for the excellent cooperation extended to us during the audit. We look forward to discussing our comments and recommendations with you. If you have any questions or require assistance in the implementation of our recommendations, please call us at your convenience.

Very truly yours,

Plante & Moran, PLLC

A handwritten signature in black ink, reading "Beth Bialy". The signature is written in a cursive style with a large, stylized "B".

Beth A. Bialy

A handwritten signature in black ink, reading "Wendy Trumbull". The signature is written in a cursive style with a large, stylized "W".

Wendy N. Trumbull